I’ve heard it argued that market forces don’t apply to health care because there isn’t anything close to a free market in health care. There are all these government programs, and there’s insurance, and patients don’t have as much information as doctors. The list of market “imperfections” is a long one. Supply and demand just don’t function in such an environment, says the skeptic.

Part of that kind of talk is rhetoric—a way to frame the debate. But it’s more than rhetoric. To a lot of people, the inherent logic makes sense. And one source for the sympathy some have for this argument comes from college economics classes, I suspect.

In economics textbooks and in college classrooms, there’s something called perfect competition. Perfect competition is a theoretical idea. It assumes there are a huge number of small sellers, so that no one seller can have a significant impact in determining the price. It assumes that the buyers and sellers are aware of all the prices being charged in the market. It assumes that the good being bought and sold is homogeneous, so that buyers make all decisions based only on price.

The textbooks go on to analyze how the supply and demand for the good in question produce a price and how that price adjusts to various changes. This is the bread-and-butter of most economics classes in college.

And is there any market out there that conforms to the assumptions of perfect competition? Wheat. Maybe. At least that’s the answer you’ll find in a lot of textbooks and classrooms.

This may explain why most conversations I have with strangers about economics leave me so depressed. I’ll be on an airplane and the person next to me will ask me what I do for a living. When I tell them I teach economics, I usually get one of the following responses:

“Do you think the stock market will go up this year?”

“I took economics in college. That’s the subject that works in theory but not in the real world.”

Both responses lower my spirits. But there’s something special about the second one. Who would want to teach economics if that second quote is an apt description of the field? Who would want to study something in graduate school for four years that can’t be applied to the real world? It would be like studying the life of a newt on Jupiter. It might be an interesting intellectual challenge. But why would you devote your life to it? And why would you want to communicate that knowledge to thousands of undergraduates across the country and the world?

I think about those poor students learning about “perfect competition.” If you’re taught a theory that requires a large number of all-knowing sellers interacting with lots of all-knowing buyers, buying and selling a
product that’s identical, with price the only form of competition, why that’s obviously malarkey. And it’s malarkey that’s particularly pernicious because it appears to be designed for one purpose and one purpose only—to make undergraduates suffer through final exams rather than helping to understand the world around us.

And then when you think about health care, why it seems obvious that it has nothing to do with that class you took back in college called economics. After all, there’s nothing homogeneous about it, so how can you talk about the demand for “health care”? Seems absurd. There are usually only a few hospitals in any one city. Surely they have a large role in determining price. And the amount of knowledge that buyers have about prices is minimal. Obviously, supply and demand have nothing to tell us about health care. Ergo, you can’t even talk about the market for health care. And if it does exist, it’s a mess and there’s no point in using “market forces” to reform it.

As Alexander Pope observed, a little learning is a dangerous thing. It’s true that the market for health care doesn’t fit the model of perfect competition very well. It’s not a “free market,” whatever that is. But incentives always matter. They matter in free markets, constrained markets, controlled markets, command-and-control economies, family life, and religious life. And if there are newts on Jupiter, incentives matter to them, too.

**Market Forces Matter**

Even in the weird real world of health care, far, far away from the textbook model of perfect competition, incentives and supply and demand still influence behavior.

If we put price controls on pharmaceuticals and lower the return to discovering new drugs, then pharmaceutical companies will spend less money on research and they will discover fewer new drugs.

If we mandate insurance coverage of new eyeglasses, people will buy more eyeglasses. The price of health insurance will be higher.

If the government pays for old people or poor people’s health care, the demand for health care will increase, and prices will rise.

If we restrict the number of people who can go to medical school, prices will rise.

If we pass tax laws that encourage employers to offer health insurance, more health care will be used and prices will rise.

And so on and so on. The fact that the health-care market isn’t a perfect match with the textbook case of supply and demand does not repeal the laws of human nature. Incentives matter. For wheat, yes. And most everything else.